

MONETARY POLICY STATEMENT

PRESS CONFERENCE

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Luis de Guindos, Vice-President of the ECB**

Frankfurt am Main, 15 December 2022

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Good afternoon, the Vice-President and I welcome you to our press conference.

The Governing Council today decided to raise the three key ECB interest rates by 50 basis points and, based on the substantial upward revision to the inflation outlook, we expect to raise them further. In particular, we judge that interest rates will still have to rise significantly at a steady pace to reach levels that are sufficiently restrictive to ensure a timely return of inflation to our two per cent medium-term target. Keeping interest rates at restrictive levels will over time reduce inflation by dampening demand and will also guard against the risk of a persistent upward shift in inflation expectations. Our future policy rate decisions will continue to be data-dependent and follow a meeting-by-meeting approach.

The key ECB interest rates are our primary tool for setting the monetary policy stance. The Governing Council today also discussed principles for normalising the Eurosystem's monetary policy securities holdings. From the beginning of March 2023 onwards, the asset purchase programme (APP) portfolio will decline at a measured and predictable pace, as the Eurosystem will not reinvest all of the principal payments from maturing securities. The decline will amount to €15 billion per month on average until the end of the second quarter of 2023 and its subsequent pace will be determined over time.

At its February meeting the Governing Council will announce the detailed parameters for reducing the APP holdings. The Governing Council will regularly reassess the pace of the APP portfolio reduction to ensure it remains consistent with the overall monetary policy strategy and stance, to preserve market functioning, and to maintain firm control over short-term money market conditions. By the end of 2023, we will also review our operational framework for steering short-term interest rates, which will provide information regarding the endpoint of the balance sheet normalisation process.

We decided to raise interest rates today, and expect to raise them significantly further, because inflation remains far too high and is projected to stay above our target for too long. According to Eurostat's flash estimate, inflation was 10.0 per cent in November, slightly lower than the 10.6 per cent recorded in October. The decline resulted mainly from lower energy price inflation. Food price inflation and underlying price pressures across the economy have strengthened and will persist for some time. Amid exceptional uncertainty, Eurosystem staff have significantly revised up their inflation projections. They now see average inflation reaching 8.4 per cent in 2022 before decreasing to 6.3 per cent in 2023, with inflation expected to decline markedly over the course of the year. Inflation is then projected to average 3.4 per cent in 2024 and 2.3 per cent in 2025. Inflation excluding energy and food is projected to be 3.9 per cent on average in 2022 and to rise to 4.2 per cent in 2023, before falling to 2.8 per cent in 2024 and 2.4 per cent in 2025.

The euro area economy may contract in the current quarter and the next quarter, owing to the energy crisis, high uncertainty, weakening global economic activity and tighter financing conditions. According to the latest Eurosystem staff projections, a recession would be relatively short-lived and shallow. Growth is nonetheless expected to be subdued next year and has been revised down significantly compared with the previous projections. Beyond the near term, growth is projected to recover as the current headwinds fade. Overall, the Eurosystem staff projections now see the economy growing by 3.4 per cent in 2022, 0.5 per cent in 2023, 1.9 per cent in 2024 and 1.8 per cent in 2025.

The decisions taken today are set out in a [press release](#) available on our website.

I will now outline in more detail how we see the economy and inflation developing and will then explain our assessment of financial and monetary conditions.

Economic activity

Economic growth in the euro area slowed to 0.3 per cent in the third quarter of the year. High inflation and tighter financing conditions are dampening spending and production by reducing real household incomes and pushing up costs for firms.

The world economy is also slowing, in a context of continued geopolitical uncertainty, especially owing to Russia's unjustified war against Ukraine and its people, and tighter financing conditions worldwide. The past deterioration in the terms of trade, reflecting the faster rise in import prices than in export prices, continues to weigh on purchasing power in the euro area.

On the positive side, employment increased by 0.3 per cent in the third quarter, and unemployment hit a new historical low of 6.5 per cent in October. Rising wages are set to restore some lost purchasing power, supporting consumption. As the economy weakens, however, job creation is likely to slow, and unemployment could rise over the coming quarters.

Fiscal support measures to shield the economy from the impact of high energy prices should be temporary, targeted and tailored to preserving incentives to consume less energy. Fiscal measures falling short of these principles are likely to exacerbate inflationary pressures, which would necessitate a stronger monetary policy response. Moreover, in line with the EU's economic governance framework, fiscal policies should be oriented towards making our economy more productive and gradually bringing down high public debt. Policies to enhance the euro area's supply capacity, especially in the energy sector, can help reduce price pressures in the medium term. To that end, governments should swiftly implement their investment and structural reform plans under the Next Generation EU programme. The reform of the EU's economic governance framework should be concluded rapidly.

Inflation

Inflation declined to 10.0 per cent in November, mainly on the back of lower energy price inflation, while services inflation also edged down. Food price inflation rose further to 13.6 per cent, however, as high input costs in food production were passed through to consumer prices.

Price pressures remain strong across sectors, partly as a result of the impact of high energy costs throughout the economy. Inflation excluding energy and food was unchanged in November, at 5.0 per cent, and other measures of underlying inflation are also high. Fiscal measures to compensate

households for high energy prices and inflation are set to dampen inflation over next year but will raise it once they are withdrawn.

Supply bottlenecks are gradually easing, although their effects are still contributing to inflation, pushing up goods prices in particular. The same holds true for the lifting of pandemic-related restrictions: while weakening, the effect of pent-up demand is still driving up prices, especially in the services sector. The depreciation of the euro this year is also continuing to feed through to consumer prices.

Wage growth is strengthening, supported by robust labour markets and some catch-up in wages to compensate workers for high inflation. As these factors are set to remain in place, the Eurosystem staff projections see wages growing at rates well above historical averages and pushing up inflation throughout the projection period. Most measures of longer-term inflation expectations currently stand at around two per cent, although further above-target revisions to some indicators warrant continued monitoring.

Risk assessment

Risks to the economic growth outlook are on the downside, especially in the near term. The war against Ukraine remains a significant downside risk to the economy. Energy and food costs could also remain persistently higher than expected. There could be an additional drag on growth in the euro area if the world economy were to weaken more sharply than we expect.

The risks to the inflation outlook are primarily on the upside. In the near term, existing pipeline pressures could lead to stronger than expected rises in retail prices for energy and food. Over the medium term, risks stem primarily from domestic factors such as a persistent rise in inflation expectations above our target or higher than anticipated wage rises. By contrast, a decline in energy costs or a further weakening of demand would lower price pressures.

Financial and monetary conditions

As we tighten monetary policy, borrowing is becoming more expensive for firms and households. Bank lending to firms remains robust, as firms replace bonds with bank loans and use credit to finance the higher costs of production and investment. Households are borrowing less, because of tighter credit standards, rising interest rates, worsening prospects for the housing market and lower consumer confidence.

In line with our monetary policy strategy, twice a year the Governing Council assesses in depth the interrelation between monetary policy and financial stability. The financial stability environment has deteriorated since our last review in June 2022 owing to a weaker economy and rising credit risk. In addition, sovereign vulnerabilities have risen amid the weaker economic outlook and weaker fiscal positions. Tighter financing conditions would mitigate the build-up of financial vulnerabilities and lower tail risks to inflation over the medium term, at the cost of a higher risk of systemic stress and greater downside risks to growth in the short term. In addition, the liquidity needs of non-bank financial institutions may amplify market volatility. At the same time, euro area banks have comfortable levels of capital, which helps to reduce the side effects of tighter monetary policy on financial stability. Macroprudential policy remains the first line of defence in preserving financial stability and addressing medium-term vulnerabilities.

Conclusion

Summing up, we have today raised the three key ECB interest rates by 50 basis points and, based on the substantial upward revision to our inflation outlook, we expect to raise them further. In particular, we judge that interest rates will still have to rise significantly at a steady pace to reach levels that are sufficiently restrictive to ensure a timely return of inflation to our two per cent medium-term target. Keeping interest rates at restrictive levels will over time reduce inflation by dampening demand and will also guard against the risk of a persistent upward shift in inflation expectations. Moreover, from the beginning of March 2023 onwards, the APP portfolio will decline at a measured and predictable pace, as the Eurosystem will not reinvest all of the principal payments from maturing securities.

Our future policy rate decisions will continue to be data-dependent and determined meeting by meeting. We stand ready to adjust all of our instruments within our mandate to ensure that inflation returns to our medium-term inflation target.

We are now ready to take your questions.

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I have two questions. One on “the significantly higher rates at a steady pace”. Does that mean we are going to see more 50-basis-point hikes in the future? And how many do you envision if you see significantly higher rates?

On QT, quantitative tightening, how do you decide which one do you reinvest and which not? Is there also a metric behind?

On the first one, I'm glad that you picked up the key messages that are really embedded in this monetary policy statement that I have just read for you. One of the key messages, in addition to the hike that we decided today, is the indication that not only will we raise interest rates further, which is something that we had said before, but we also say that today we judged that interest rates will still have to rise significantly at a steady pace to reach levels that are sufficiently restrictive, to ensure a timely return of inflation to our 2% medium-term target. I'm reading straight from the monetary policy statement, first paragraph, because that is the one that really includes the four key messages that we have. One of them is that we, at this point in time, expect and judge that we will have to raise interest rates significantly. Now, what does that mean? You have to read it together with the steady pace. It is pretty much obvious that, on the basis of the data that we have at the moment, significant rise at a steady pace means that we should expect to raise interest rates at a 50-basis-point pace for a period of time.

The second element that you have in this paragraph is the reference to a steady pace, so it's significant, and it has to be a steady pace, which means that we have made progress over the course of the last few months, but we have more ground to cover. We have longer to go, and we are in for a long game.

On your second question, which is relating to the second part of our decision, about the quantitative tightening, or the reduction of the size of our balance sheet, where we decided the key principles, so predictable, measured, and we had said that at this particular meeting we would come with key principles. Clearly, the first principle is the starting point, which we have agreed would be early March 2023. And we have also agreed on the monthly average calculated over a period of four months until